CENTRAL BANKS OR SINGLE FINANCIAL AUTHORITIES? A POLITICAL DELEGATION APPROACH

1.Introduction

This paper presents an analysis of recent trends and determinants in the architectures of financial supervision. We wish to explore theoretically and empirically the unification process in the financial sector supervision, testing our hypotheses with sample of 69 countries.

The financial supervision regimes vary significantly from country to country. A review of the financial supervision architectures[1] indicates a trend toward a gradual concentration of supervisory powers. In Europe this trend toward the unification of supervisory powers has been rather strong in recent years: in addition to the Norway - the first country to establish a single supervisor in 1986 - and the Iceland (1988), five other countries, members of the European Union - Austria, Denmark (1988), Germany (2002), Sweden (1991) and United Kingdom(1997) - have assigned the task of supervising the entire financial system to a single authority different and independent from the central bank. Also four countries involved in the EU enlargement process - Estonia (1999), Latvia (1998), Malta (2002) and Hungary (2000) - have reformed their structures, concentrating all the powers in a single authority[2], while out of Europe the unified agency was established in Korea (1997) and Japan (2001).

The aim of the theoretical, institutional and empirical analyses is therefore to discover the dynamics in financial supervisory regimes, and their determinants – if any - in a worldwide cross-border perspective.

From the methodological standpoint, we develop in a delegation approach the classic intuitions of the new political economy[3], applied in the financial supervision area[4]. We base our work on two main hypotheses: the definition of the supervisory regime is endogenous; the choice of policymakers to maintain or reform a given supervisory regime is constrained and influenced by the structural economic and institutional features of their own countries, rather than by a generic, ill-defined social welfare function. Furthermore, it will be quite natural to acknowledge the suggestions of the recent new comparative economics[5].

In other words the thesis that it will be tested is the following: in a given country, the optimal financial supervisory design is dependent on structural economic and institutional features. Each financial supervisory architecture is confirmed or reformed by the policymakers, who in turn are influenced by the economic and institutional structure of their countries. Therefore, the financial supervisory architecture can be considered an endogenous variable, which depends on a set of medium/long-term features.

The paper is organized as follows. Focusing on the key issue in the debate on financial supervisory structure – single supervisor versus multi-authorities model – Section two claims that the optimal

---

[1] The review is performed in Section four.

[2] De Luna Martinez and Rose (2001) claim there are at least other seven countries considering to adopt a form of integrated supervision: Bulgaria, Indonesia, Kazakhstan, Poland, Slovakia, Slovenia and Ukraine. European Central Bank (2003) claims that a single supervisory authority will likely be established in Belgium.

[3] For the new political economy approach see Drazen (2000) and Persson and Tabellini (2000).

[4] For the theory of financial regulation see Llwellyn (1999), (2001), and Estrella (2001).

[5] For the law, endowment and finance literature see Beck, Demirguc – Kunt and Levine (2002). See also La Porta et al. (1998), (1999).

degree of unification in the financial supervisory regime cannot be defined *a priori*; rather it is an expected variable, calculated by the policymakers that maintains or reform the financial architectures. Therefore in Section three the adopted approach is to consider the supervisory structure with one or more authorities as an *endogenous* variable, determined in turn by the dynamics of other structural variables, economic and institutional, that can summarize and explain the political delegation process. In order to construct an endogenous variable, in Section four it is introduced a Financial Authorities' Concentration Index (FAC Index), to have an indicator of the degree of unification of powers. Then in Section five it is considered the nature of the institutions involved in the control responsibilities. In particular, we must ask what role the central bank plays in the various national institutional settings. It is introduced an index of the central bank's involvement in financial supervision, the Central Bank as Financial Authority Index (CBFA Index). Using both the FAC Index and the CBFA Index we shed light on the current trends in the financial supervision architecture. In Section six, to empirically gauge the possible determinants of the degree of concentration of powers, it is performed an econometric analysis of the Probit and Logit types. Section eight put forward some conclusions.

2. Financial Supervision Architectures: The Traditional Approach

From the conceptual point of view, our starting point is obviously the *blurring effect*[6] that current developments in the banking and financial industry are having on supervisory issues[7]. Increasing integration has taken place between the banking, securities and insurance markets, as well as among the corresponding products and instruments. The blurring effect produces in particular two intertwined phenomena: the emergence of *financial conglomerates*[8], that is likely to produce important changes in nature and dimensions of the single intermediaries, as well as in the degree of consolidation of the banking and financial industry; the growth of the *securitisation* of traditional forms of banking activities and the proliferation of sophisticated ways of bundling, repackaging and trading risks, that weakened the classic distinction between equity, debt and loans[9], leading changes in nature and dimensions of the financial markets.

The financial blurring process poses at least three questions in the debate on financial supervision structure[10]: sectoral (institutional) approach versus functional approach; single supervisor model versus multi-authorities model; and, particularly in the European Union, centralized setting versus decentralized setting[11].

It is a fact that, in the perspective of increasing financial integration, the relevance of the first question has been rapidly declining. Theoretically, the sectoral approach is based on the possibility of separating the banking, securities and insurance markets. The progressive erosion of market separation is likely to cause the "default" of the institutional approach[12]. Institutionally, the above

[6] See the "classic" Corrigan (1987).
[7] See Dale (1997) and White (1997).
[8] See European Commission (2002) and de Luna Martinez and Rose (2003).
[9] de Luna Martinez and Rose (2003).
[10] See Di Giorgio and Di Noia (2002).
[11] The range of possible models for the structure of financial supervision at a national and a European level is identified by Kremers, Schoenmaker and Wierts (2001).
[12] For a deeper analysis see Masciandaro and Porta (2004). See also Di Giorgio and Di Noia (2002) and Schoenmaker (2003).